Sheltering Development Profits

Julie Butler shows how straightforward tax planning can maximise a farmer's return

There are many ways in which today's modern farmers can diversify and create development opportunities on and within the land they own. The use of Business Asset Taper Relief greatly aids today's diversifying farmer and there are many opportunities for the farmer to make use of this very beneficial relief.

Business Asset Taper Relief

Business Asset Taper Relief (BATR) legislation has resulted in an attractive maximum capital gains tax rate of 10% (75% taper relief followed by a 40% tax rate) from 6 April 2002 (*Taxation of Chargeable Gains Act 1992,* Schedule A1, paragraph 5(1A)). The farming community has enjoyed (and should still enjoy) some very attractive tax shelter from the trade of farming where farmland has been sold for development. The alternatives are endless for a farmer who wants to continue to be able to shelter future development gains.

Mixed-use or dual use of an asset and BATR

From 6 April 2004 (under *Finance Act 2003,* section 160) let land qualifies for BATR, but what about the periods before 6 April 2004? In order to claim the 75% BATR (100% BATR eligibility), the assets must have been used only for business purposes from 6 April 1998.

The tax position of let farmland prior to 6 April 2004 is complex. From 6 April 1998, the landowner had to be in partnership with the tenant to qualify for BATR. From 6 April 2000, it was sufficient for the land to be let to any unlisted trading company (the aim of the tax planning has to be to achieve 'pure' taper relief so as to minimise the CGT payable).

When an asset is simultaneously used for more than one purpose, one of which would qualify the asset as a business asset and the other would not, there is 'mixed use'. In a farming situation, a typical example would be where a farmer who is a sole trader owns a barn and one part of it is used for the purposes of the farm and the other part is let out.

Where either of the above applies, *Taxation of Chargeable Gains Act 1992*, Schedule A1, paragraph 9 introduces an apportionment calculation. This is a very complex calculation where it is necessary to calculate the relevant fraction of each mixed-use period for which the asset is used for a non-qualifying purpose. Such a calculation shall be made on a just and reasonable basis. The relevant fraction represents the proportion for which the asset has been used for non-qualifying purposes.

It is essential to identify mixed-use assets and inform the client before the disposal. This is of most relevance where there is a potential disposal at a large gain (for example, for development).

Agricultural land with hope for development lends itself to tax planning to improve on this position. There is scope to transfer the land into new ownership to try to ensure that full untainted taper relief is achieved after two years – for example, a transfer to a new trust.

Until 6 April 2004 letting land did not count as the trade of farming. Let land that qualifies now will still be 'tainted'. It will have mixed use since it did not qualify for the 75% relief before 6 April 2004.

Examples of how to achieve pure taper relief would be to transfer the land into a trust (or advance from one trust to another). But the *Finance Act 2004* stopped this from December 2003, if the settlor is 'interested' in the trust. It is better to consider outright gifts now (there is a ruse using transfers of partial interests to spouses which later merge). The gain can be held over and the land held for a two-year period and hopefully qualify for 100% BATR before the land is ultimately sold out of the family for development or otherwise.

Farmers trading in land

Where land is sold for development realising a capital gain, the Revenue may seek to apply *Income and Corporation Taxes Act 1988*, section 776 rather than the capital gains tax legislation. The Inland Revenue are not saying that the farmer is trading in land, but developing it with 'the sole or main object of realising a gain from disposing of the land when developed'. It is more beneficial to the Inland Revenue to tax the profits in this way.

A formal Inland Revenue clearance procedure is available in respect of transactions potentially falling into charge under this section (subsection 776(11)), though this is rarely used in practice.

Should the landowner become a developer for tax purposes (voluntarily or involuntarily), land previously held as a farm asset will be appropriated to the trading stock of the new trade. On this change of status CGT arises on a deemed disposal at market value (*Taxation of Chargeable Gains Act 1992*, section 161). Tax planners should try to ensure that all the CGT reliefs are utilised on the deemed disposal.

The question of sheltering development profits from tax can attract the 'reluctant farmer' into the farming world in order to take advantage of the tax reliefs.

Retaining rights over the land

Commercially, it may be beneficial to retain some right over the land in order to keep some control over future development. Ransom strips or covenants can be used to protect the landowner. Ransom strips trigger the part-disposal rules. Covenants are a capital asset and so again result in a part-disposal. Their value will be difficult to ascertain and so they will have negligible cost.

Sale of land to a developer – not trading in land

A farmer who has owned land with no intention of selling does not become a developer just because he takes steps to enhance the value of the property to a developer who might want to acquire the land (*Taylor v Good* [1973] STC 383).

'Development' is not defined by statute. The Inland Revenue interpretation is any physical adaptation or preparation for new use of land.

The increase in value created by planning consent, representing the difference between agricultural value and development value, can raise problems if matters are not thought through first.

Owner of tenanted land with development value

Prior to 6 April 2004 (before *Finance Act 2003*, section 160 came into force), tenanted land with development value constituted a non-business asset for taper relief purposes – not much help if the land later gets sold for development. It would probably be possible to offer an incentive to procure a surrender of the tenancy. Such a transaction should not be entered into without the help of a lawyer.

The Lands Tribunal case of *Baird's Executors v Commissioners of Inland Revenue* [1990] SVC 188 did confirm that a tenancy had a value, but gave no guidance as to how the value should be ascertained. The Revenue approach has broadly been to regard one-half of the difference between the tenanted and the vacant possession values of the freehold as being the value of the tenancy.

Option agreements – timing and business usage

In many cases the landowner will sell his land to a professional developer and this will be classed as a CGT disposal.

However, the possibility of progressive and deferred sales and the use of option agreements should be considered.

If a series of options are entered into with the sole aim of obtaining CGT annual exemptions, then the basic principles of *Ramsay*, extended by *Furniss v Dawson*, cannot be overlooked: the Inspector will be very aware of general anti-avoidance rules.

To avoid the restriction of rollover relief or the loss of BATR, ensure that land over which an option has been granted does not stand unused, or become incapable of use because it is inaccessible as a result of work that the developer has started on adjacent land. This can happen during the construction of motorways or other developments. *Tax Bulletin Issue 2* (February 1992) set out the position that the Inland Revenue accept that rollover relief on replacement of business assets is available in respect of a grant of an option over land by reference to the underlying land, though the land has to be occupied as well as used for the purposes of the claimant's trade to qualify.

Does the option qualify for BATR?

An option is not a part-disposal of the underlying land over which the option is granted (*Taxation of Chargeable Gains Act 1992*, section 144). The grant of the option is the disposal of a separate asset. Because the option itself is not a part-disposal, it does not matter how long the underlying land has been held by the person granting the option.

In a straightforward situation where the option is never exercised, the capital gain arises on the grant of the option and no BATR will be due. Once the option is exercised, the disposal created by the grant of the option is cancelled (subsections 144(2) and (3)) and the sums received for both the grant and the exercise of the option are aggregated in one disposal at the time of the exercise. BATR then applies to the aggregated consideration and is determined by reference to the date of the exercise, and by reference to the period of ownership of the asset disposed of (*Taxation of Chargeable Gains Act 1992,* Schedule A1, paragraph 13).

If the asset changes status from being a business asset to a non-business asset between the date of the grant and exercise of the option, the apportionment rules will apply to the whole gain and part of the gain will lose business asset status. Similar restrictions apply where there is partial non-business use of the asset between the grant of the option and its exercise.

Where the change is unavoidable, a contract that crystallises accrued gains at the date the change of status of the asset occurs will ensure the whole gain to date qualifies for the higher business rate of taper relief.

The Barker Review

Currently, property developers only pay tax when they sell the land they have developed. The *Barker Review of Housing Supply* proposes that a new tax – described as a planning-gain supplement – is charged much earlier, when planning permission is granted. This may be bad news for property developers, as they will not have realised any cash at that stage.

Deferred consideration

The *Finance Act 2003* introduced an additional entitlement to capital loss relief by adding a new tax relief under *Taxation of Chargeable Gains Act 1992,* section 279A. The section recognises problems, which may arise where consideration for the disposal of an asset is represented by, or includes, a deferred unascertainable amount. This will frequently arise where an asset is sold and the whole or part of the consideration is deferred and can only be determined at some future date.

However, it remains necessary to value the 'right to receive future consideration' when establishing the chargeable gain or allowable loss on the occasion of the initial disposal. This is important when looking at the computation of tax.

The Set-Aside Scheme – land disposals and CGT

The EU Commission indicates that it wants to maintain set-aside and it will continue with this policy.

The fact that land has been set-aside will not affect the basis of computation of any gains arising when some, or all, of the land is disposed of. In particular, rebasing (*Taxation of Chargeable Gains Act 1992*, section 35) will only apply to such a disposal if the taxpayer owned, or is deemed to have owned, that land as at 31 March 1982.

Where the set-aside land is left fallow, the Revenue takes the view that farming nevertheless continues on the land and that the set-aside receipts are income of the farming trade. Where the whole of the arable land of a farmer is set-aside this still applies.

Conclusion

Reliefs should also be considered when looking at compulsory purchase of land, reclamation of contaminated land and 'freehold reversion' (purchase by a sitting tenant).

An advisor to a farmer should be aware of the reliefs available and also help the farmer to plan for the future. Income tax will also need to be considered when looking at profits from let land, though this is a relatively straightforward area.

The main advisory service that can be provided is looking at the farm's potential and considering ways to shelter gains that may arise, whether this be by the use of a trust, ensuring that the asset has been held for the correct amount of time in the correct entity, or simply by advising on the different positions with regards to Rollover Relief versus BATR. Examples of this are that land and buildings have to be sub-divided for Rollover purposes and this creates a tax planning tool in itself.

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